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ABSTRACT

This lesson plan was developed through "Economics International," an international program to help build economic education infrastructures in the emerging market economies. It provides a lesson description; appropriate grade level; economic concepts; content standards and benchmarks; related subjects; instructional objectives; time required for lesson completion; materials needed; a detailed step-by-step procedure for classroom implementation; assessment exercises; and extension readings. The lesson also contains a visual and two activity sheets. Students develop the circular flow model of economic activity, acting as members of a family who move through the economy and are involved in all components of the circular flow. (BT)

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National Council on Economic Education

Economics International

Active Learning Lessons

A Lesson about the Circular Flow

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- advises on development of standards, curricula, and assessment tools
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ACTIVE LEARNING LESSONS:
A Lesson about the Circular Flow

Author: Janet Landfried

Description: The presentation of the circular flow of the economy is usually taught as a macroeconomics concept involving businesses, household, and government. In this lesson, students develop the circular flow model of economic activity, acting as members of a family who move through the economy and are involved in all components of the circular flow. After participating in this activity, students will be able to develop components of circular flow in an economy.

Grade Level: 12 through 18 year-olds.

Economic Concepts:

- markets
- goods and services
- circular flow
- role of government

Content Standard 18: A nation's overall levels of income, employment, and prices are determined by the interaction of spending and production decisions made by all households, firms, government agencies and others in the economy.

Grade 8, Benchmark 3: When consumers make purchases, goods and services are transferred from businesses to households in exchange for money payments. That money is used in turn by businesses to pay for productive resources (natural, human, and capital)and to pay taxes.

Related Subjects: language arts - creative writing

Instructional Objectives:

- Students will identify components of the circular flow of the economy.
- Students will identify the role of an individual in factor and product markets.
- Students will explain the circular flow model of an economy.

Time Required: three class periods

1. Instructor introduces the circular flow.
2. Students illustrate the circular flow.
3. Students discuss their families and their interaction in the economy.

Materials Required:

- overhead projector
- transparency of Visual 1
- copy of Visual 1 and Activity 1 for each student
- copy of Activity 2 for the teacher
- two sheets of art paper, 8 ½" x 11" or smaller, for each pair or group of students.
- colored pencils or crayons for each pair or group of students
- one large sheet of butcher paper, approximately 3' x 5'
- paste or tape

Procedure

Day 1

1. Explain that the circular flow is a model used to illustrate economic interactions among groups in the economy.
   Note: A model is a simplification of the real world.

2. Display Visual 1 and explain that there are two types of markets in the circular flow- product markets and factor markets. Households, businesses, and governments interact as buyers and/or sellers in these markets.

3. Remind students that both goods and services are products. Also, factors of production include: labor - people working; land or natural resources- things found in or on the earth; and capital - things produced by people and used in the production of other goods and services.

4. Explain that households and businesses also interact through financial institutions such as banks.

5. Distribute a copy of Visual 1 and Activity 1 to each student, and tell students that they should follow along as an explanation of the circular flow is provided. They should make notes on the pages as needed.

6. Explain that the arrows on the diagram represent the flow of factors of production such as labor and capital resources; the flow of products; and the flow of money in the economy.

7. Explain how goods, services, factors of production, and money payments move through the economy by providing the following explanation for each arrow on Visual 1.

Arrow 1:
In product markets, consumers buy goods and services that are produced by private businesses. For example, students buy food, clothing, notebooks, paper, automobile insurance, and movies at the theater.

Arrow 2:
Consumers spend income to purchase these goods and services. In order to pay for the goods and services they buy, students use income they earn baby-sitting, working at fast-food restaurants, or other jobs. They might also use part of their parents' income.

Arrow 3:
Businesses produce goods and services to sell in the product markets. There are many, many businesses providing a wide variety of goods and services that students buy.

Arrow 4:
Businesses receive revenues for the sale of their goods and services. When a student buys a new pair of jeans, he or she pays the store from which the jeans were purchased. This payment is revenue for the store.

Arrow 5:
Households provide labor and other factors of production to businesses in factor markets. When students work, they provide labor in factor markets.

Arrow 6:
Households receive income for the factors of production that they provide. In exchange for work, they expect to receive payment in the form of wages or salaries.

Arrow 7:
Businesses employ labor and other factors of production in the factor markets to produce goods and services. Businesses hire workers and employ other factors of production to produce goods and services that consumers are willing and able to buy.

Arrow 8:
Businesses have costs of production for the labor and other factors of production they employ. When businesses hire workers and employ other factors of production, the businesses must pay the owners of these factors of production. These payments are the businesses' costs of production.

Arrow 9:
Through government contracts, private businesses produce government goods and services. Local contracting firms are hired to produce local

government buildings, such as a new courthouse, or to build local roads and bridges.

Arrow 10:
Businesses receive revenues from government for the goods and services produced as a result of government contracts. When a local contracting firm builds a new court house in a city, the firm receives payment from the government.

Arrow 11:
Businesses pay income taxes on their profits. Businesses pay taxes to federal, state, and local governments.

Arrow 12:
Governments provide public goods that facilitate business operations, such as fire and police protection, roads, and the legal system. Governments use some of the tax revenue collected to produce goods and services.

Arrow 13:
Governments make welfare payments and payments to members of the armed forces and other government employees. Governments use some tax revenue to pay people who work for the government and to transfer income to those living in poverty.

Arrow 14:
Households provide labor skills in the government. In exchange for the work they do as government employees, workers expect to receive payment in the form of wages or salaries.

Arrow 15:
Households pay income, sales, and property taxes.

Arrow 16:
Governments provide public goods such as education, public health services, and parks. These public goods are used by households.

Arrow 17:
Households save part of their income in financial institutions. Saving is income that isn't spent on current consumption or taxes. Households earn interest on their savings.

Arrow 18:
Businesses borrow money from financial institutions. Financial institutions lend money that is on deposit to businesses. Businesses use this money

to invest in capital goods with which they may build new factories or buy new tools and equipment. Businesses pay interest on these loans.

1. Tell students that they will hear the story of "J. Schmoe Meets C. Flow." They should listen for references to the circular flow in the story.

2. Read the story on Activity 2, and discuss the following:

    a. How is Joann Schmoe involved in the circular flow? *(She provides labor in factor markets by working as a police officer. She pays taxes to government.)*
    b. How is Podunk Paving and Boot Company involved in the economy? *(It provides a good in a product market - resurfaced roads. The company hires workers such as Joe Schmoe in factor markets. The company sells boots in the product market. The company borrows money from Podunk Bank to expand. The company pays corporate income taxes.)*
    c. Who uses these resurfaced roads? *(households, businesses, and governments)*
    d. How is Joe Schmoe involved in the economy? *(He provides labor in factor markets by working for Podunk Paving and Boot Company. He saves some of his wages at Podunk Bank. He pays taxes.)*
    e. How is Joey Schmoe involved in the economy? *(Joey uses money he receives from his father to buy boots in product markets.)*
    f. How is Podunk National Bank involved in the economy?*(It accepts deposits in accounts. It makes loans.)*
    g. How is Podunk City government involved in the economy?*(It uses tax dollars to provide police patrols and resurface roads.)*
    h. How are you or members of your family involved in the circular flow? *(My mother is a teacher. I paid taxes out of my last paycheck. I recently bought some boots. I have a job at McDonalds. I must go to court for my traffic ticket.)*

Day 2

1. Remind students of the story of "J. Schmoe meets C. Flow." Point out that the story illustrated the components of the circular flow and how people participate in the circular flow of the economy.

2. Tell students that they will draw the circular flow and illustrate it with a story of their own.

3. Explain that, as a class, they must select the following:

    a. a family name for the household *(The Bears could be a family name.)*

b. members of the family and their names *(The Bear family might consist of Teddy and his wife Pooky, son Ruff, daughter Snooky, and cousin Hugo)*
c. a name for the family business *(The Bear family business might be The Honey Pot, a restaurant.)*
d. a name for the local bank *(First Main of Bearsville)*

4. Tell students that they will work with a partner or in a small group and use the newly created "family" to demonstrate, through illustrations, how a family is involved in the circular flow of the economy.

5. Explain that each pair or group of students will be assigned a particular component of the circular flow to illustrate. The group must show connections between the sectors of the economy, the product and factor markets, and its family. They may use any depiction, within reason, to draw and show connections. They may also include written descriptions to complete their illustrations.

6. Divide the students into twelve pairs or small groups. Distribute paper and crayons or colored pencils to each group. Assign the groups two of the following: households, businesses, government, product markets, factor markets, financial institutions, and each of the 18 arrows.

7. For clarification, offer the following example to illustrate the Bear family's involvement in the economy as business owners. Teddy and Pooky Bear own a restaurant. They pay taxes on the profit their business earns. They are happy to be near the fire station.

8. Explain that students would write the word "Businesses" on the top of the paper. Then they might draw a picture of The Honey Pot Restaurant with a smiling Teddy and Pooky in the window and a drawing of the fire station down the street. This illustrates the family's involvement in the business segment of the economy and its connection to government through taxes and provision of public goods (the fire-station).

9. Allow at least one-half hour for the students to complete their illustrations.

10. Tape a large piece of butcher paper on a wall in the classroom. Display Visual 1. Tell students to paste or tape their illustrations in the proper order, using Visual 1 and Activity 1 as a guide.

Day 3 Closure

1. Use Visual 1 and the students' posters to review circular flow by asking each pair of students to point out and explain its illustration in the following order:

a. product market
b. factor market
c. households
d. businesses
e. government
f. financial markets
g. arrows 1 through 18.

2. Discuss the following:

h. What are the types of markets in the circular flow? *(product and factor)*
i. What groups interact in these markets? *(households, businesses, and governments)*
j. Who owns the factors of production and offers them in the factor market? *(households)*
k. What are the factors of production? *(land, labor, and capital)*
l. Who employs factors of production in the factor market? *(government and businesses)*
m. Why do businesses and governments employ factors of production? *(to produce goods and services)*
n. Who consumes goods and services produced by businesses? *(households and governments)*
o. Who consumes goods and services produced by government? *(households and businesses)*
p. How do you participate in the circular flow? *(I provide labor in factor markets because I work at a fast-food restaurant. I pay taxes to the state and federal government. I buy goods and services in product markets. I pay sales tax on the goods and services I buy. I have a savings account at the local bank.)*

Assessment

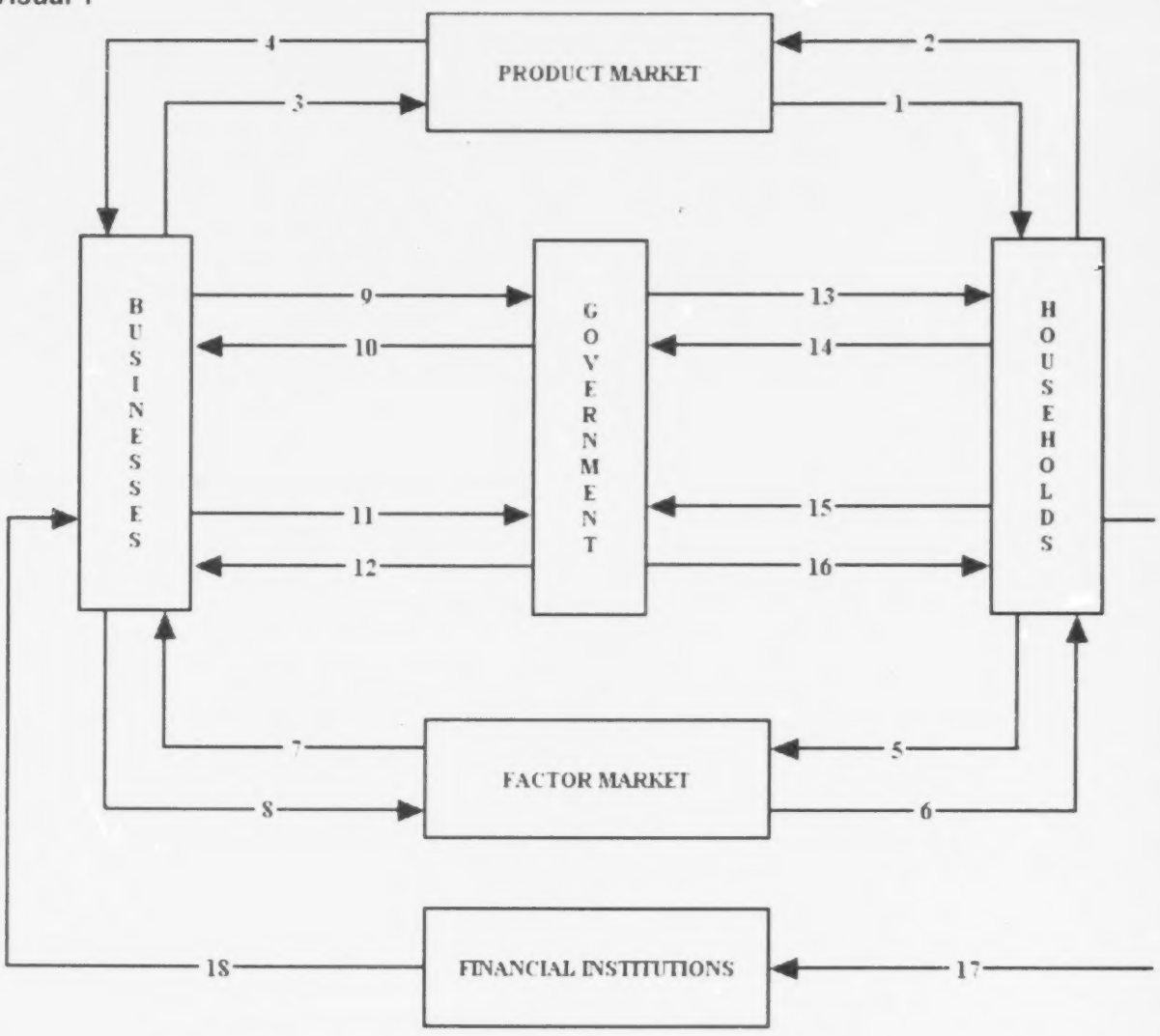
Remove the poster of the students' work from view. Distribute 2 sheets of paper to each student. Tell the students to draw and label the circular flow model. The drawing must include the components of the circular flow and the arrows connecting those components. On the second sheet of paper, students should explain each arrow.

Extension

1. "A Market in Wheat," *Focus: High School Economics*, National Council on Economic Education, 1996.
2. "Markets Interact," *Focus: High School Economics*, National Council on Economic Education, 1996.

3. "Learn More, Earn More," *Focus: High School Economics*, National Council on Economic Education, 1996.
4. "Public Goods and Services," *Focus: High School Economics*, National Council on Economic Education, 1996.

Visual 1


PRODUCT MARKET
4
3
2
1
BUSINESSES
GOVERNMENT
HOUSEHOLDS
9
10
11
12
13
14
15
16
FACTOR MARKET
7
8
5
6
FINANCIAL INSTITUTIONS
18
17

ACTIVE LEARNING LESSONS:
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Activity 1
18 Steps to Building a Circular Flow Model

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Activity 2
J. Schmoe Meets C. Flow

Joann Schmoe is employed as a police officer in Podunk. A portion of her salary from the city is paid back to the city in the form of taxes.

When the City of Podunk receives those tax dollars, they hire Podunk Paving and Boot Company to resurface roads within the Podunk city limits. This helps Joann do her job of patrolling the city.

When Podunk Paving and Boot Company gets the contract to resurface the roads, they hire a new worker, Joe Schmoe, Joann's couch-potato hubby who has been unemployed! Joe is now being paid excellent wages. He banks some of his salary at Podunk National Bank and gives some to his son, Joey Schmoe.

Joey Schmoe is now able to buy those new Podunk designer boots he's been wanting since they became a fad at Podunk High.

Meanwhile, Podunk Paving and Boot has been able to borrow some money from new deposits recently made at Podunk National Bank.

Podunk Paving and Boot is able to expand, do more paving, produce more fashionable boots, increase its profits, and pay more taxes.

When the City of Podunk receives this new tax revenue, it increases police patrols in the city that makes it less likely that Podunk Paving and Boot, the Schmoe family, and Podunk National Bank will be victims of crime.

Everyone is, therefore, happier and more secure. They are also more productive and this leads to more spending that leads to more jobs that leads to increased incomes and tax revenues that leads to more spending that leads to more jobs that leads to increased incomes and tax revenues that leads to more spending that leads to more jobs that leads to more . . . and so on because it's not really . . . The End

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